

VZCZCXRO8177  
PP RUEHDBU  
DE RUEHKV #3128/01 2231327  
ZNY CCCCC ZZH  
P 111327Z AUG 06  
FM AMEMBASSY KIEV  
TO RUEHC/SECSTATE WASHDC PRIORITY 0904  
INFO RUCNCIS/CIS COLLECTIVE  
RUEHZG/NATO EU COLLECTIVE  
RHEBAAA/DEPT OF ENERGY WASHINGTON DC

C O N F I D E N T I A L SECTION 01 OF 04 KIEV 003128

SIPDIS

SIPDIS

DOE FOR LEKIMOFF, CCALIENDO

E.O. 12958: DECL: 08/11/2016

TAGS: [EPET](#) [ENRG](#) [PREL](#) [PGOV](#) [PBIO](#) [RS](#) [TX](#) [UP](#)

SUBJECT: UKRAINE: ENERGY MINISTERS ON NEW GOVERNMENT'S  
PLANS FOR GAS TRADE, PIPELINES, AND NUCLEAR ISSUES

Classified By: ADCM Michelle Logsdon; Reasons 1.4 (b) and (d)

¶1. (C) Summary. In August 10 meetings with Ambassador, Deputy Prime Minister Andriy Kluyev and Minister of Fuels and Energy Yuriy Boyko made clear that the new GOU was determined to reach a good outcome in dealings with Russia and Turkmenistan on natural gas supplies. Boyko was confident that Ukraine would be able secure such an outcome through "strategic cooperation" with Gazprom. Kluyev was short on details but promised transparency in any future dealings, while Boyko was unapologetic about the January 4 deal and the role it accorded RosUkrEnergo (RUE). RUE's task, Boyko said, remains to supply Ukraine with sub-\$100/tcm gas, apparently by any means possible. Neither official expressed a preference on what form a potential International Gas Consortium would take, though Kluyev hinted that the Consortium's might include activity within Russia. Both Kluyev and Boyko said economic and commercial factors should determine the future of the Odesa-Brody pipeline. Both supported Holtec's project to build the Central Spent Nuclear Fuel Storage Facility and said they would urge Rada approval of the building site. Kluyev hoped for a quick and definitive resolution from the EBRD's investigation of the flawed Chornobyl Shelter tender. End Summary.

¶2. (SBU) In separate meetings on August 10, Ambassador discussed the new GOU's approach to energy issues with Deputy Prime Minister Andriy Kluyev, and with Minister of Fuel and Energy Yuriy Boyko (former head of Ukraine's oil and gas monopoly, Naftohaz). Kluyev noted he was responsible for Ukraine's real economy sectors, to include the Ministries of Agriculture, Industrial Policy, Energy, Coal, Emergencies, and Environment. Boyko was accompanied by his colleague from the tiny Republican Party -- Ukraine's former Ambassador to the U.S. Konstantin Hryshchenko, who, Boyko said, would soon be heading up a Ukrainian think tank.

The Gas Deal  
-----

¶3. (C) Ambassador asked both Kluyev and Boyko for their thoughts on the prospects of revising the notoriously non-transparent January 4 gas deal. The U.S., Ambassador said, would support efforts to revise the deal in order to make it more transparent and to enhance Ukraine's energy security. DPM Kluyev said his office was still reviewing all the documents, and while it was too early to make a final decision, the GOU had a path forward and would find a way to ensure a stable gas supply for Ukraine and stable gas transit system to Europe. (Note: Kluyev did not share details on this path forward. End Note) Next week, Kluyev said, Ukraine would begin bilateral consultations with Russia and Turkmenistan on 2007 gas supply. Kluyev vowed that

transparency would be a primary condition for any future deal, since he knew the prestige of Ukraine was at stake. (Note: These points on transparency were repeated in a press release on the meeting issued by Kluyev's office August 10. End Note.)

14. (C) Minister Boyko (along with Kluyev a key architect of the 2004 gas contract that had guaranteed Ukraine the right to buy Russian gas at \$50/tcm for six years) laid out the history of energy middleman RosUkrEnergo (RUE). RUE, Boyko explained, was Ukraine's way out of the situation created in April 2003 when Turkmenbashi signed a contract to sell all Turkmen natural gas to GazProm. At the time, this implied an end to direct Ukrainian purchases of Turkmen gas. Ukrainian president Kuchma tasked then NaftoHaz Chairman Boyko to secure Ukraine's gas supplies. The solution, Boyko found, was to create a Ukrainian-Russian joint venture -- RUE. A key component of the deal was to finance an expansion of pipeline capacity in Uzbekistan and Kazakhstan to increase Turkmen gas exports to Russia. RUE partner Dmytro Firtash took care of these finances, Boyko said. Russia, in turn, agreed to in-kind payments of cheap Turkmen gas to Ukraine in return for transit of its gas exports to Europe. RosUkrEnergo, for its efforts, would be able to recoup its financing of the Central Asia-Center pipeline expansion by then re-exporting some of this Turkmen gas from Ukraine.

15. (C) The situation was more difficult now, Boyko said. Turkmenistan's President Niyazov wanted \$100 per thousand cubic meters (tcm) at his border. Adding transit costs, the price would be \$150/tcm at the Ukrainian-Russian border. At present, Ukrainian law prohibited gas supplier to sell to industrial consumers at prices more than \$110/tcm. The chemical industry would come to a standstill if the price went higher than \$120/tcm, Boyko claimed, while the metals

KIEV 00003128 002 OF 004

industry could survive with a price no greater than \$190-200/tcm. Boyko said the GOU was talking to RUE and to Turkmenistan on how to address this issue. "RUE's job," Boyko said, "is to deliver gas to Ukraine at less than \$100/tcm; I don't care how they do it." He explained that RUE's gas sales to European customers would make this possible.

16. (C) Ambassador pointed out that having European customers essentially subsidize Ukrainian energy consumption was not sustainable. The GOU should be trying to move the country gradually to world prices. Boyko agreed that the current solution had to be temporary, but countered that the GOU's task was to purchase gas at the lowest price possible. As he had told Gazprom, Ukraine would need two or three years (which Boyko later in the meeting lengthened to three to four years) to adjust. When Ambassador asked if Gazprom had agreed to this time frame, Boyko said "we will be able to find a compromise through our strategic cooperation." When asked what this cooperation would entail, Hryshchenko piped in that it was too early to discuss such matters. The new GOU had been in office less than a week, Hryshchenko said, and the answer to this question would be much clearer once PM Yanukovych returned from his meetings in Moscow the following week.

International Gas Consortium  
-----

17. (C) Kluyev expressed no preference on what form a possible International Gas Consortium (IGC) would take. The ruling coalition would first consult and pass any consortium concept to the Rada for approval. Kluyev said that the views of Yushchenko's Our Ukraine, which originally opposed the IGC, would also matter if, as he expected, the party joined the ruling coalition in September. In principle, Kluyev said he supported a consortium that included companies involved in gas supply and consumption, but said he would perhaps expand the consortium's activities to include Southwestern Russia.

18. (C) Comment: Boyko did not mention the IGC, but his allusion to "strategic cooperation" with Gazprom could be a hint that the GOU would make tradeoffs in order to achieve its objective of cheap gas. One such tradeoff could be some measure of Russian participation in management of future or existing Ukrainian pipelines. Another possibility is Kluyev's reference to possible Ukrainian involvement in Russian production. Kluyev may have been referring to Astrakhan, located on the edge of the Caspian Sea on the Volga river delta. In May 2006 press reports indicated Dmytro Firtash's RUE had purchased a 74.87% stake in Astrakhan Oil and Gas Company. Astrakhan government officials confirmed the deal, while Firtash denied it. Astrakhan Oil and Gas Company has estimated reserves of 220 bcm of gas and 20 million tons of oil. End Comment.

#### Energy Advisors

-----

19. (C) Ambassador noted that the USG had funded advisors to work with the past two governments on energy matters, and inquired whether the GOU would be interested in continuing to receive this advice. Both Kluyev and Boyko said the GOU still needed to discuss this issue, but noted they had worked with one of the experts in the past. Boyko agreed to meet with the advisors when they were next in Kiev September 5 - 19. Kluyev merely noted that the advisors had his phone number.

#### Off-Shore Tenders

-----

110. (C) Kluyev did not comment on whether there would be additional tenders for off-shore oil and gas exploration, saying his office had not yet looked into this topic. He acknowledged the importance of passing Production Sharing Agreement (PSA) legislation that would enable American company Vanco, which had won the March off-shore exploration tender, to begin drilling. The legislation would also apply to other companies working onshore or offshore in the extractive sectors. Kluyev expected the new Rada would pass the necessary legislation this fall. Ambassador noted that USG was providing a PSA consultant to review existing legislation and draft new implementing legislation, and offered additional technical assistance if needed. Kluyev replied that most of the work was already done, though if a consultant had some good ideas, the GOU would of course consider them.

KIEV 00003128 003 OF 004

111. (C) When Ambassador raised the question of PSA legislation with Boyko, the Minister responded that he would meet with Vanco and explain what potential problems they may face. Although Boyko did not elaborate on what these problems might include, Hryshchenko quickly interjected that the biggest challenge would be getting the PSA legislation through the Rada. Boyko said he would order his deputy minister (and former Ambassador to Turkmenistan) Vadim Chupron to help Vanco as the company's designated "curator."

#### Odesa-Brody

-----

112. (C) Kluyev said there was too much talk about the Odesa-Brody pipeline; action was needed either to build its extension into Poland or to accept that its operation in the northern direction was not operationally feasible. Kluyev stated that Odesa-Brody's future should be based on its commercial prospects, noting that when politicians got involved in building projects the results were "stillborn babies." There was a normal, commercial way to go about developing pipeline projects; simply putting a pipe in the ground for the sake of supply diversification was not a

serious approach, Kluyev said. Kluyev continued that in April 2004 Ukraine and Poland had signed an agreement to extend the pipeline into Poland, but nothing had been done since. The GOU would consult with participant suppliers and consumers and then make a decision on the pipeline and its direction, Kluyev said.

¶13. (C) When asked about Odesa-Brody's future, Boyko digressed into the past, claiming that the 2004 reversal to ship Russian oil south rather than Caspian oil north to Europe was a technical step to keep the pipeline from deteriorating. He echoed Kluyev's view that the key uncertainty concerned extending the pipeline across Poland. He said he thought there was still great interest both in Poland and on the part of Chevron and even BP-TNK to use the pipeline, and that north-bound shipments of oil through the pipeline now made economic sense. (Comment: Although Boyko is thought to have been the key player in executing the 2004 pipeline reversal, he does not seem to have had recent dealings on this issue. He conceded that his conversations with the Poles, Chevron, and BP took place two years ago. End Comment.)

#### Nuclear Issues -----

¶14. (C) Kluyev said he was well acquainted with Holtec, the company selected to build a central spent nuclear fuel storage facility, having met with them in the past. He said he would support their project and urge the Rada to approve the storage facility's building site during the Rada's September session. Kluyev was also aware of Holtec's work to complete the Chornobyl Interim Spent Nuclear Fuel Storage Facility. Boyko said he had a high opinion of Holtec and agreed to meet with the company on the building site issue.

¶15. (C) Neither Kluyev nor Boyko appeared aware of the non-proliferation program which the U.S. funds through the IAEA to remove highly enriched uranium from the Sevastopol University for Nuclear Energy and Industry for return to Russia for storage. (Note: CabMin approval of the shipment of uranium to Russia is required.) DPM Kluyev pledged to look into this project, while Boyko's associate Hryshchenko claimed it was not an issue for the Minister of Fuels and Energy.

¶16. (C) Kluyev shared his opinion that the Chornobyl Shelter tender had not been conducted according to the tender's rules, and noted that information on the tender process was in his office at the Cabinet of Ministers. (Note: U.S. company CH2M Hill filed a formal complaint about tender improprieties and EBRD has been investigating the matter. The first meeting of the committee investigating this issue was held on August 10. End Note.) Kluyev hoped the project would begin as quickly as possible following the successful resolution of the EBRD investigation.

#### Bio Notes and Comment -----

¶17. (C) With the appointments of Boyko and Kluyev, the Yanukovych government seems to be trying to recreate the Kuchma-era style of managing energy issues -- through

KIEV 00003128 004 OF 004

personal relationships in the former Soviet Union and back-room deals. Kluyev is returning to a position he held from 2003-2004 under Kuchma, though now with a slightly wider portfolio including agriculture. Beginning in 2005 he was head of the Rada's Fuels and Energy Committee. In our meeting Kluyev's manner was at times curt and brusque, just as he was in a meeting three weeks ago. Gone apparently was the contriteness and introspection seen from post-Orange Revolution, oppositionist Kluyev. Kluyev's manner today seemed to project that he was back in charge and moving ahead with his plans; and, as for what those plans were, he would

reveal on his terms and at his time.

¶18. (C) Under Kuchma, Boyko was one of the architect-proponents of the 2002 International Gas Consortium, the 2004 Odesa-Brody reversal, and the founding of RosUkrEnergo. Gazprom has put the International Gas Consortium back on the table in recent months, suggesting Ukraine could get cheaper gas prices if it agreed to creation of the consortium.

¶19. (C) Early August press reports recall that Boyko managed NaftoHaz from January 2002 - March 2005 with the non-transparency characteristic of "developed Kuchmism." At that time he maintained good relationships with Gazprom and Turkmenistan's President Niyazov, for whom he translated Niyazov's book of spiritual musings, the Rukhnama, into Ukrainian. Kuchma awarded Boyko in 2004 the Hero of Ukraine medal for negotiating a profitable gas deal with Turkmenistan that gave Ukraine Turkmen gas for \$44/tcm. If Boyko has maintained his friendships over the past 18 months, another Turkmen gas deal again may be in the works. Based on past experience, any Boyko-bartered deal could well be creative but non-transparent.  
Gwaltney